

Doing Business in Japan

2011



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1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 80 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Japan has been provided by the office of UHY representatives:

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Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current at April 2011

We look forward to helping you do business in Japan.

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2. Business environment

Japan is one of the world's economic superpowers and its prosperity is based on its efficient industries (automobile, information and communication technology and consumer electronics). Japan has accelerated high-level technology development in the environmental, medical care and biotechnology sectors. Japan has also promoted a culture-oriented industry referred to as 'Cool Japan'.

Population

Japan has an approximate population of 127 million inhabitants, with an average population density of 336 people per square kilometre (490 per square mile).

Area

Japan covers 377,930 km², and is formed by 47 local government districts.

Language

Japanese

Since most Japanese studied English during their student age, English is the most popular foreign language.

Legal system

The Japanese Constitution provides the democratic foundation for the separation of state powers, (i.e. Legislative, Judicial and Governmental). The Judicial power is vested in the Supreme Court and lower courts established by law. Lower courts are divided into four arms: High Courts, District Courts, Family Courts and Summary Courts.

Currency

Yen

Cost of living

The standard of living and living costs in Japan are famous for being one of the highest in the world. Some of the world's most expensive real estate is found in central Tokyo. However, real estate prices in Tokyo have been declining since the massive earthquake in March 2011.

Employment

The Japanese labour market was characterized by lifetime employment until the mid-90s, although there has been a prevailing trend of irregular

employment. The labour force was 62.9 million, with an unemployment rate of 4.6% in February 2011.

GDP

The nominal GDP was 479 trillion yen (\$5.5 trillion) in 2010, the third largest in the world after the United States and China.

The economy

Japan suffered a long-term economic recession during the 1990s after its assets price bubble in the late 80's broke. The government adopted policies to promote exports and Japan's economy was on a gradual recovery trend from 2003 to 2007 with steady economic growth. However, the global financial crisis dried up global demand for Japan's export and Japan went into recession in 2008. The government stimulus spending helped to bring the Japanese economy back on track in late 2009 and 2010. Subsequently, the massive earthquake in March 2011 caused enormous damage in the northeastern coastal region and Japan is facing rebuilding struggles.

Main trade partners (in 2010)

Main export destinations	% of total
People's Republic of China	19.4
United States	15.4
South Korea	8.1
Taiwan	6.8
Hong Kong	5.5
Thailand	4.4
Singapore	3.3
Germany	2.7
Malaysia	2.3
Netherlands	2.1

Main origin of imports	% of total
People's Republic of China	22.1
United States	9.7
Australia	6.5
Saudi Arabia	5.2
UAE	4.2
South Korea	4.1
Indonesia	4.1
Taiwan	3.3
Malaysia	3.3
Thailand	3.0

Stock exchange

The Tokyo Stock Exchange(TSE) is the third largest [stock exchange](#) in the world. TSE had 2,292 listed companies with a combined market capitalization of US\$3.8 trillion as of December 2010. TSE is broken into three separate sections: large companies, mid-sized companies and Mothers (market of the high-growth and emerging stocks) for venture companies. The Osaka Securities Exchange (OSE) and Nagoya Stock Exchange (NSE) are also important stock exchanges in Japan.

3. Foreign investment

There are a number of reasons for investing in Japan:

- Large consumer market with a population over 127 million
- Financial centre
- Key trading hub in Asia
- A high degree of control over the Asian market
- Highly advanced technology
- A leading center for innovation, research and development in Asia.

Investment support

Japan External Trade Organization (JETRO)

JETRO is a governmental organization with more than 70 overseas offices in over 50 countries across the world. For foreign companies planning to start a business in Japan, JETRO Invest Japan Business Support Centre (IBSC) will provide consultation and facilities for establishing a business base.

JETRO IBSC staff and advisors provide information and consultation, including:

- Market and industry information
- Relevant legal systems
- Taxation, labour and legal issues
- Networking with potential business partners
- Finding human resources and an office location
- Information on the regulations and incentives from national and local governments.

National and local authorities offer a number of incentives to promote investment. Among them are: preferential tax policies such as reduction or exemption of business taxes, fixed asset taxes and real estate acquisition taxes, subsidies, the provision of land and buildings and taxes related to financing and lending systems. In addition to information on these incentives, IBSC can arrange meetings with representatives from national and local authorities.

The Office of Trade and Investment Ombudsman (OTO)

The Office of Trade and Investment Ombudsman (OTO) is a government body for promotion of investment from abroad. OTO is the contact point when problems arise due to government regulations for export to or investment in Japan. OTO reaches relevant government ministries and agencies including customs houses, counsellor offices, regional economic

trade and industry bureaus, general quarantine offices, animal quarantine stations, plant epidemic prevention stations, regional transport bureaus, embassies and consulates as well as JETRO offices.

4. Setting up a Business

Foreign investors who intend to set up a business in Japan can choose from a wide range of legal entities. The most common legal entities available in Japan are:

- Representative offices
- Branch offices
- Companies (private).

It is possible to choose another entity type depending on the situation.

Representative Office

Before officially starting business in Japan, foreign investors can use representative offices as a temporary basis for preparation. Direct business operations are not permitted at representative offices, only indirect business operations such as market surveys, collecting information and advertising are allowed. A Representative office is not allowed to open bank accounts or lease real estate in its own name. For such purpose, a headquarters' manager or a representative office manager must use his or her name. Establishment of representative offices do not need to be registered with any administrative authorities. Set-up procedures for a Representative office are:

Point	Representative Office
Purpose	To gather information and advertise in Japan
Tax Condition	Not considered as "Permanent Establishment (PE)" in Japan.
Set up procedures	<ol style="list-style-type: none">1) Establish a representative office.2) Acquire a certificate of status of residence from the Ministry of Justice's Immigration Bureau.3) Submit certificate of status of residence to the Japanese consulate in the representative's home country, Japanese consulate visa.4) After entering Japan, the representative determines place of residence and performs alien registration procedures.5) Open bank account (in the case of a representative office, only a personal account can be opened).6) Register employee information with Labour Standards Inspection office, Public Employment Security office, Social Insurance office and Tax office (wage payment related information).

Point	Representative Office
Condition for PE	<ol style="list-style-type: none"> 1. Branch, plant or other operating resident in Japan. 2. Working for over one year to build the building in Japan. 3. An attorney is needed for the foreign company. 4. No tax for no PE. 5. If a Representative office receives income on the sale or rental of real estate or receives interest and dividends (withholding tax 20%), tax is imposed.

Branch office

Foreign investors may find a branch office as the simplest mean to establish a business base in Japan. A branch office can start business operations after deciding a base of operation, appointing the branch representative and registering necessary information. A Japanese branch office can open bank accounts and lease real estate in its own name. However, a branch office does not have independent corporate status. It is treated as a part of a foreign company incorporated overseas. The foreign company is ultimately responsible for all the debts and credits incurred by the business activities of its Japanese branch.

Corporation

When foreign companies intend to establish a subsidiary of their existing business in Japan, they must choose a corporation type. Japanese Corporation Law recognizes four types:

- Joint-stock corporation (Kabushiki-Kaisha (“K.K.”)),
- Limited liability company (Godo-Kaisha (“GK”))
- Unlimited partnerships (Gomei-Kaisha)
- Limited partnerships (Goshi-Kaisha).

The last two types are granted corporate status under the Japanese Corporation Law, though rarely chosen in practice because equity participants bear unlimited liability.

All types of subsidiary companies are established by completing legal procedures and are required to be registered. Once the registration is processed, they can open bank accounts, rent or lease a property and engage in activities as a legal entity. A Japanese subsidiary company is considered a separate entity from the foreign company, so all debts and credits generated by a subsidiary belong to the subsidiary.

Kabushiki Kaisha (“K.K.”)

A Kabushiki-Kaisha (“K.K.”) is the most common form of corporate entity used in Japan by foreign investors. Its shareholders’ liability is limited to their capital contributions. The formation procedures for K.K. are as follows:

Steps	Remarks
1. Basic matters	Company name, company objectives, address of head office, paid-in capital, accounting period, bank for accepting share subscription money, etc.
2. Search for similar company name	At the Legal Affairs Bureau
3. Preparation of Articles of Incorporation	Be careful for company objectives
4. Company seal	1) Acquire seal for the company and representatives at a seal carver 2) Obtain certificate seal registration at Ward office.
5. Promoter meeting	Preparation of a minutes of the promoter meeting Two copies of the meetings must be prepared
6. Notarization of the Articles of Incorporation	Notarization is done at a public notary office (Stamp duty JPY40,000 and a notary fee JPY50,000)
7. Appointment of a bank to handle the share subscription money	The selection of a bank for future operation is very important.
8. Public offering	Allotment of shares to the parent company.
9. Payment of the share subscription money to the bank	
10. Certificate by the receipt of the share subscription money	Issued by the bank
11. Establishment meeting by the subscribers	Appoint directors and auditors
12. Board of director meeting	Approval of directors; minutes must be taken.
13. Register of Establishment	Application for registration (with a registered representative seal and Registration and license tax of JPY150,000 or 0.7% of paid in capital)

Steps	Remarks
14. Surrender the share	
15. Notification under the Foreign Exchange Law	Register with the Bank of Japan within 15 days
16. Tax registration	With Legal Affairs (Tax, social securities and Labour office)

Godo Kaisha (GK)

A Godo-Kaisha (GK) is an entity loosely based on the US LLC. The investor's liability in the GK is limited to their capital contribution. A GK is more flexible than a K.K. and well-suited for smaller companies. Unlike the US LLC, a GK is not available for pass-through income taxation for Japanese tax purposes. The formation and legal structure of a GK is similar to that of a K.K. but much simpler. Unlike a K.K., each GK member is responsible for managing the affairs of and representing the GK.

Gomei-Kaisha

A Gomei-Kaisha is a company with unlimited liability members. They are jointly and severally responsible for the company's liabilities.

Gosh-Kaisha

A Goshi-Kaisha is similar to a Gomei-Kaisha except there are members with unlimited liability and limited liability.

A foreign company may invest in Japan using a method other than the described above, for example, establishing a joint venture with a Japanese company or equity participation in a Japanese company.

5. Labour

Employment is classified in two categories:

- Regular
- Temporary (part-time and dispatch)

There have been major changes to the employment environment in Japan in the last 20 years. In 1999 and 2003, the government revised the Worker Dispatch Law that fundamentally eased regulations on the use of temporary workers. This made the use of temporary work prevalent in Japanese companies.

Regular employment

Regular employment (often referred as “permanent employment” in Japan) is regular full-time employment that includes benefits, such as health insurance, paid time off and retirement allowance. Most Japanese companies traditionally use permanent employment, and many people regarded their employment as a life-time assignment for them. However, the permanent employment system inevitably raised personnel costs in regards to maintaining senior employees. To cope with an increasingly open economy and build international competitive advantage, the government adopted policies of labour market deregulation such as the revision of the Worker Dispatched Law.

Temporary employment

Temporary employment refers to a situation where the employee is expected to leave the employer within a certain period of time. Temporary workers may work full-time or part-time, depending on the individual case.

Part-time

Part-time workers have shorter working hours per week than regular workers in the same working place. In some cases they are given benefits (such as health insurance) but not a full benefit package. Regular pay hikes, bonus payment and retirement allowances are generally not applied to them. However, the Part-Time Employment Act was revised to protect part-time workers. For example, part-time workers' abilities should be used effectively and working conditions should be balanced with those of regular employees in the same workplace.

Dispatch

Dispatched workers are workers who have employment contracts with temporary work agencies. The agencies send dispatched workers to work at the companies in need of short-term workers. Dispatched workers are also used in work that has a cyclical nature which requires frequent adjustment of staffing levels. The Worker Dispatched Law prohibits the dispatch of workers in some industries, including port transport, construction, guard services and medical services.

Working conditions

Foreign employees are protected by the Labour Standards Law and other related laws as well as Japanese employees. These laws are designed to ensure that there is no discrimination or unfair treatment of employees.

Work permits and visas

Employers are only able to employ individuals who have permission to live and work in Japan. Generally, foreign people who have one of the following residential statuses have the right to work in Japan.

- Permanent resident
- Spouse or child of Japanese national
- Spouse or child of permanent resident
- Long-term resident

Foreigners are permitted to work in the following professions or services:

- Professor
- Artist
- Religious activities
- Journalist
- Investor/business manager
- Legal/accounting services
- Medical services
- Researcher
- Instructor
- Engineer
- Specialist in Humanities and International services
- Intra-company transferee
- Entertainment
- Skilled labour
- Designated activities

Detailed information is provided by the Immigration Bureau of Japan.

Contract of employment

Employers are required to enter into labour contracts with employees. Employers also need to provide written notification about employment conditions, including:

- Place of work;
- The duties that the employee will have to perform;
- Working hours;
- Holidays;
- The methods of determining, calculating and paying wages;
- Matters pertaining to resignation and dismissal.

Probation period

A permanent contract of employment will usually have a probation period of three months. Employers are allowed to terminate the employee during or after the probation period if reasons of termination are objectively reasonable.

Wages

Employers must pay the wages to employees in full at least once a month, on a fixed date. Employers are also required to deduct income tax, social insurance premiums and similar expenses from wages of their employees.

Guarantee of minimum wages

Minimum wage depends on the industry and the region. Industrial minimum wages are applied to certain industries and usually set higher than the regional minimum wages. If regional and industrial minimum wages differ, the higher of two will be applied. As of 2010, regional minimum wages range from ¥642 to ¥821 per hour for all workers. Minimum wages do not include cost of commuting, overtime pay and temporary pay. They must be paid exclusively to employees.

Retirement benefit

Most Japanese companies have some form of retirement benefits or severance pay system. Retirement benefits are calculated based on the length of service, reason of leaving the company. Retirement benefits are treated more favourably for tax purposes than ordinary pay.

Extra pay

Employers must pay employees for overtime work, work on holidays and mid-night work. Japanese laws and regulations establish rules for how to calculate these extra pays. They are paid on top of the regular wage. To determine overtime pay, the employer must calculate at a rate of 25% or more of the regular wage, for work on holidays at least 35% and for work during the night (between the hours of 10 pm and 5 am) at least 25%.

Advance notice of dismissal

In the case of dismissing an employee, the advanced notice period is usually at least 30 days. If an employer fails to give timely advance notice with no reasonable excuse, the employer must pay the employee the amount of average wage for the number of days falling short of the 30 days advanced notice.

Working hours, breaks and days off

The statutory working hours are eight hours a day, 40 hours a week. However, as an exception, working up to 44 hours a week is permitted for certain businesses. These businesses include retail and beauty services, theatres, businesses related to health and hygiene, as well as restaurants and entertainment businesses with less than 10 regular employees. The statutory holidays are one day a week or four days or more in a four week period.

Labour and social insurance systems

Employers are legally obliged to take part in labour and social insurances. There are four kinds (listed below) of insurance systems. Employers pay their portion of insurance premiums to the authorities together with employee's portion of insurance premiums, which are deducted from employees' wages.

1. Workers' Accident Compensation Insurance: It covers work-related injuries and diseases including accidents while commuting to or from work.
2. Employment Insurance: It provides temporary financial assistance for unemployed people while they look for work or upgrade their skills.
3. Health Insurance and Nursing Care Insurance: It covers medical and nursing care expenses for employees.
4. Employees' Pension Insurance: It provides benefits for employees to cover the income of households after retirement and likely risks, such as disability and death.

Workers' Accident Compensation Insurance and Employment Insurance are referred collectively as Labour insurance. Health, Nursing Care and Employees' Pension Insurances are referred to collectively as Social Insurance.

6. Taxation

Residency of companies

For the purpose of applying the Corporation Tax Law of Japan, a company which is headquartered or has its main office in Japan is considered a domestic company. A company is considered a foreign company if it is headquartered or its main office is outside of Japan.

Note: Taxpayers subject to the corporation tax law of Japan are corporations, including those established by special laws, under the company law or other corporation laws or under the civil code. This document focuses only on companies established under the company law of Japan or equivalent laws of foreign countries.

Taxation on domestic companies and foreign companies

A domestic company is liable to pay corporation tax on its worldwide income. A foreign company is liable to pay corporation tax on its domestic source income.

Domestic income

Domestic income is income from business conducted in Japan or from using, holding or transferring assets located in Japan. There are considerations for conducting business providing personal services in Japan, considerations for the lending of real estate or any right on real estate located in Japan, interests on Japanese government bond, dividends from domestic companies and other income as prescribed by the corporation tax law.

The scope and kinds of domestic source income subject to corporation tax varies with type of permanent establishment (PE) held by a foreign company. Three types of P.E. are prescribed by the corporation tax law: branch, factory or other fixed place of business (Item 1 PE); activities of construction, installation or assembly (Item 2 PE); agent of the foreign corporation (Item 3 PE).

Taxable income and tax year

Taxable income is net revenue less deductions (cost, expenses and losses). It is to be calculated in accordance with generally accepted accounting principles and provisions of the corporation tax law. The tax year for the calculation of taxable income is to be the same as the accounting year used for financial reporting purposes.

A company is allowed to carry forward net loss (negative taxable income as the net of revenue less deductions (cost, expenses and losses) in a tax year to use as a deduction in the succeeding seven years, as long as the company has the blue form tax return filing status. The blue form tax return filing status is given to a company filling requirements prescribed by the corporation tax law of keeping records of transactions, having obtained the permission by the Director of the District Tax Office and having filed its tax return every year on a timely basis.

Local taxes on company's income

A company is liable to pay local taxes on its income in addition to the above mentioned corporation tax to be paid to the national government. Currently, local taxes applicable to a company are prefectural and municipal inhabitant taxes, enterprise tax and special local corporation tax.

Tax rates of corporation tax

Corporations are taxed at a rate of 30%. The special reduced rate of 22% (18% for the tax years ending from 1 April 2009 to 31 March 2012.) is applicable to the taxable income up to ¥8 million of a small and medium sized company.

Taxable income in a year	Small and medium sized companies	Large sized companies
Up to ¥ 8 million	22%	30%
Over ¥8 million	30%	

A small and medium sized company eligible to the special reduced rate is a company whose paid-in capital is ¥100 million or less and not 100% owned directly or indirectly by a company whose paid-in capital is ¥500 million or more. Large sized company is a company whose paid-in capital is more than ¥100 million.

Tax rates of local taxes

Tax rates of prefectural and municipal inhabitant taxes

Prefectural and municipal inhabitant taxes are calculated based on the amount of corporation tax of a company. Applicable tax rates which can be determined respectively by a prefecture and a municipality vary between standard rate and maximum rate

	Standard rate	Maximum rate
Prefecture	5.0%	6.0%

Municipality	12.3%	14.7%
Total	17.3%	20.7%

In addition to taxes on corporation tax amount, a company is liable to pay per capita inhabitant taxes to prefectures and municipalities based on the amount of paid-in capital and the number of employees.

Tax rates of enterprise tax

Enterprise tax, imposed by prefectures, is calculated based on the amount of the taxable income of a company. Applicable tax rates determined by each prefecture, varies between a standard rate and a maximum rate.

Taxable income in a year	Paid-in capital of ¥100 million or less		Paid-in capital of more than ¥100 million	
	Standard rate	Maximum rate	Standard rate	Maximum rate
Up to ¥4 million	2.7%	3.24%	1.5%	1.8%
Over ¥4 million up to ¥8 million	4.0%	4.8%	2.2%	2.64%
Over ¥8 million	5.3%	6.36%	2.9%	3.48%

Tax rates of special local corporation tax

Effective 1 October 2008, a special local corporation tax is imposed by prefectures. It is calculated based on the amount of taxable income multiplied by the standard rate of enterprise tax. Tax rates are as follows.

Paid-in capital of ¥100 million or less	Paid-in capital of more than ¥100 million
81%	148%

Special local corporation tax was introduced as a temporary measure to adjust inequality in tax revenue among local governments. Please note that tax rates of enterprise tax shown in the above table is the temporarily reduced rates which were revised corresponding to the introduction of special local corporation tax.

Effective tax rate

Enterprise tax and special local corporation tax are deductible in the calculation of taxable income for corporation tax. Taking into account the deductible nature of these local taxes, the effective tax rate is calculated as 40.83% for a company, whose paid-in capital is more than ¥100 million, assuming the maximum rates of inhabitant taxes and enterprise tax are used in the calculation.

Other Taxes

Business Office Tax

Companies whose business premises exceed 1,000 square meters and/or employ in excess of 100 employees in designated cities are subject to business office tax. Designated cities have discretion to charge the tax.

Fixed Assets Tax

Real property and tangible depreciable fixed assets are subject to fixed assets taxes at the standard rate of 1.4%.

Group Taxation Regime

Under the 2010 tax reform, the Group Taxation Regime was introduced. It is the most important revision for Japanese subsidiary companies and Japanese branch offices of foreign companies. Group taxation is designed to reduce the negative affect the separate existence of related companies has on the aggregate tax liability of the group. Group taxation provides business groups flexibility to organize their business activities, internal restructurings and asset transfers.

Generally, the rules eliminate income and loss recognition on intragroup transactions by providing for deferral. The Group Taxation Regime automatically applies to certain transactions carried out by companies belonging to the same 100% group (companies with 100% shareholding relationship directly or indirectly). The main points of the Group Taxation Regime are:

- Capital gains/losses arising from transfers of assets between Japanese companies in a 100% group are deferrable;
- Dividends Received Deduction (DRD): Dividends from wholly-owned companies (100% Japanese subsidiaries) are exempt from taxable income without deducting attributable interest expense to such dividends;
- Tax qualified dividends-in-kind between Japanese companies in a 100% group: Dividends-in-kind are assets which companies distribute as dividends other than money. Dividends-in-kind between Japanese companies in a 100% group are treated as tax qualified dividends-in-kind. Recognition of capital gains/losses from tax qualified dividends-in-kind is deferred. In addition, withholding taxes are not imposed on them;
- Donations between Japanese companies in a 100% group: A donation between Japanese companies in a 100% group is not deductible for the donating company. For the recipient company,

the donation amount is not included in its taxable income.

Special tax reliefs applied to small and medium-sized companies.

Consolidated tax regime

A Japanese 100% group can choose the consolidated filing of income tax returns. Once a 100% group adopts the consolidated filing, it is irrevocable unless specific events, such as change of ownership, occur. Note that the consolidated tax return filing system is applicable only to Japanese companies in a 100% group, not applied to foreign companies.

The greatest benefit provided by the consolidated tax regime is offsetting profits and losses within a group. A consolidated group can offset profits and losses within the group companies for national corporate tax purposes. However, some features of the consolidated tax regime may result in a tax burden. When a tax consolidated group forms or a subsidiary joins an existing consolidated group, assets of the subsidiaries will be re-evaluated to market value. These built-in gains/losses could result in additional taxation. In addition, Tax losses incurred by the subsidiary before joining the consolidated group will be extinguished.

The consolidated tax return filing system is applied only to national corporate income tax. Local corporate income taxes are imposed on member companies. Each member company has to continue to pay local corporate taxes on an individual basis although the amount payable will be affected by the existence of the consolidation.

Withholding taxes credits

Withholding taxes are imposed on incomes such as interest and dividends. In general, withholding taxes are creditable against corporate tax. Excessive amount of withholding taxes over corporate tax liability, if any, is refundable.

Foreign tax credits

A Japanese company is allowed to claim tax credits for foreign corporation tax, including foreign local tax and withholding tax that are paid directly by the Japanese company. There is a certain limit on the amount of creditable foreign tax.

Foreign Dividend Exclusion System

Under the Foreign Dividend Exclusion System., 95% of dividends from foreign subsidiaries are exempted from corporate income tax of the Japanese parent company. To apply for the Foreign Dividend Exclusion, foreign subsidiaries have to meet two qualifications:

- Hold 25% of shares or more directly or indirectly;
- Hold 25% of shares or more at least six months before the date on which the obligation to pay the dividends is determined.

The Foreign Dividend Exclusion System is not applied to subsidiaries with less than 25% shareholdings.

Transfer Pricing

Operations of transfer pricing taxation need to be properly managed, taking into consideration the fact that this taxation system is based on the arm's length principles. For this reason, it shall be operated in accordance with the basic policies stated below:

- It shall be closely examined whether the prices fixed for foreign-related transactions are equal to the prices normally fixed for uncontrolled transactions. In cases where any problem is found in the transactions, efforts shall be made to widely collect information regarding the market and the business for an appropriate examination as to the selection of the calculation method and comparable transaction, and adjustment for differences.
- To ensure the predictability of the corporation and to realize proper and smooth enforcement of transfer pricing taxation, the APA process shall be conducted in cases where an APA request regarding the TPM is submitted by the corporation, based on the contents of mutual agreement related to the APA request if there is any such agreement.
- To solve international double taxation caused by transfer pricing taxation, it is important for the tax authorities of each country to share an understanding of transfer pricing. Therefore, an examination or APA review shall be conducted in an appropriate manner by referring to the OECD Transfer Pricing Guidelines as necessary.

Consumption Tax

Japanese consumption tax, similar to a European VAT, is applied at the rate of 5% to the majority of goods and services consumed in Japan, including imports of goods and services. However, there are a number of exemptions, including the lease or sale of land, education, medical treatment and social welfare activities. Exports and certain specific services invoiced to non-residents are 0% rated.

Registration

Vendors/service suppliers must register as consumption tax payers if they have taxable sales transactions in excess of ¥ 10 million in the base period (two years before the current year). If the taxable sale in the base period is

not more than ¥10 million, the vendor/service supplier is able to elect whether or not they are treated as a consumption tax payer.

Income taxes on Individuals

Resident/non-resident status

Individuals are generally classified in four categories in accordance with the period of their residence in Japan.

Period of Residence	Status
Up to 12 months	Non-resident
12-60 months	Non-permanent resident
Over 60 months	Permanent resident

Non-resident taxpayers are considered taxable on only Japanese source income. Non-permanent resident taxpayers are taxable both on Japanese source income and part of non-Japanese source income that is paid in and/or remitted to Japan. Permanent resident taxpayers are taxable on their worldwide income.

National income tax and local inhabitant tax

Individual taxes consist of national income tax and local inhabitant tax. The tax year is the calendar year beginning on 1 January. For local inhabitant tax, taxable income is based on the previous tax year's income.

National income tax

The rate of tax levied on an individual is determined by the individuals' taxable income. As income increases, the marginal rate of tax increases. When calculating the net ordinary taxable income, a number of tax deductions are allowed which reduces the net amount of taxable income. The tax deductions available for individuals include, but are not limited to:

- Social insurance premiums paid to the Japanese government
- Life insurance premiums
- Earthquake insurance premiums
- Charitable contributions
- Qualified medical expenses
- Deductions for dependents (dependent spouse, children under 23 years old)
- Deduction for the elderly
- Deduction for the disabled.

The following table indicates tax rates applied to the net of ordinary taxable income. Calculation: taxable income × tax rate – deduction

The net taxable ordinary income (¥)	Tax rate	Deduction(¥)
0 – 1,950,000	5%	-
1,950,000 – 3,300,000	10%	97,500
3,300,000 – 6,950,000	20%	427,500
6,950,000 – 9,000,000	23%	636,000
9,000,000 – 18,000,000	33%	1,536,000
Over 18,000,000	40%	2,796,000

Local inhabitant tax - stopped

Local inhabitant tax consists of “income based levy” and “per capita levy”. The tax rate of the income based levy is 10% regardless of the amount of taxable income. As described above, taxable income for local inhabitant tax is based on the previous tax year’s income. The amount of per capita levy is ¥3,000 per capita for municipal inhabitant tax, ¥1,000 for prefectural inhabitant tax.

Capital gains

Capital gains from real estate realized by individuals are subject to tax, separately from ordinary income.

Capital gains from sales of real estate

- Short-term capital gains (for real estate held less than five years) are taxable at a 30% income tax rate and a 9% inhabitant tax rate;
- Long term capital gains (for real estate held more than five years) are taxable at 15% income tax rate and 5% inhabitant tax rate.

In the case of the sale of the individual’s residence, certain tax advantages are available (i.e., special deductions, loss carry-forward and a lower tax rate).

Stamp duty

Stamp duties are imposed on taxable documents, such as contracts and legal documents. They are imposed in the range of ¥ 200 to ¥600,000.

Important changes in new 2011/2012 (for information only)

This new tax law has been updated to reflect the tax changes arising from the proposed 2011 Tax Reform Act, as well as the special legislation promulgated to cope with the aftermath of the great eastern Japan earthquake in March 2011.

The Law to Revise the Income Tax, etc., in Order to Develop a Tax System to Address the Current Severe Economic Circumstances and Employment Conditions, Law No. 82 of 2011, consists of the fast-track legislative items

taken from the originally proposed 2011 Tax Reform Act submitted to the Diet on 25 January 2011. The tax changes include tax incentives for promoting comprehensive international strategic investment zones; tax incentives for designated multinational corporation research and development promotion enterprises; tax credit for corporations filing a blue tax return that increase employment during the year; and clarification that a company may not be treated as a medium or small-sized company if it is owned 100% by more than one large-sized company within a 100% corporate group.

The Law to Revise the Income Tax, etc., in Order to Construct a Tax System Addressing Changes in the Socio-Economic Structure, approved by the Japanese House of Representatives on 10 June 2011 consists of the remaining items from the original 2011 Proposed Tax Reform Act that will be considered during the extended legislative session along with other major tax reform proposals, including a plan to reduce the corporate tax rate, increase the consumption tax rate as well as changes to the inheritance tax and gift tax regimes.

The Special Tax Law for those Affected by the Great Eastern Japan Earthquake, Law No. 29 of 2011, aims to help taxpayers affected by the great eastern Japan earthquake. The relief measures include deduction of casualty losses resulting from the earthquake from income for the 2010 tax year; increased deductibility and special credit for earthquake-related donations; additional first year depreciation for replacement property for property damaged or destroyed due to the earthquake; deferred gain treatment on replacement of property and business assets affected by the earthquake; and carry back of losses arising from the earthquake.

Effective tax rate

Among a number of changes for the fiscal year from April, 2012, the effective corporate income tax rate decreases from 40.7% to 38.0%. Regarding decrease of 4.5% corporate tax based on taxable income, a special reconstruction tax of 10% corporate tax liability is being imposed for three years. The period for tax loss carry-forwards is extended from seven to nine years while deductible amount for large companies will be reduced from 100% of taxable income to 80%.

7. Accounting & reporting

Applicable Regulations

The Corporate law amended in 2005 regulates accounting and reporting requirement for all the companies in Japan. It requires every company to maintain accurate records and prepare the following statements for each fiscal year:

- Balance sheet
- Income statement
- Statement of changes in net assets
- Annotations for the above statements
- Business report
- Supporting schedules.

Publicly listed companies are also governed by the Financial Instruments and Exchange Law. The law requires listed companies to prepare both financial statements and internal control reports. Therefore, listed companies have to comply with two laws for disclosure. The disclosures required by the corporate law are for shareholders, while the disclosures required by the Financial Instruments and Exchange Law are for investors. Both disclosures are similar, but the Financial Instruments and Exchange Law requires listed companies more information such as cash flow statements. As for non-listed companies, only disclosures for the shareholders are required.

Accounting Standards

Financial statements must be prepared in accordance with Generally Accepted Accounting Principles in Japan (J-GAAP). J-GAAP is determined by the Financial Service Agency (FSA) and Accounting Standards Board of Japan (ASBJ). In some cases, foreign accounting standards such as United States Generally Accepted Accounting Principles (US-GAAP) or International Financial Reporting Standards (IFRS) can be used for preparation of financial statements. IFRS usage has been voluntary in Japan since fiscal 2009. J-GAAP is equivalent to IFRS, though some difference will remain until the present reviews of IFRS have been completed.

The FSA and the ASBJ has been taking major steps to secure the convergence of J-GAAP with IFRS. The FSA announced in 2009 that the mandatory implementation of IFRS on listed companies would be in 2015 or 2016 if the decision is made in 2012. The FSA also announced that the mandatory implementation of IFRS would be only on consolidated

financial statements of listed companies. J-GAAP would continue to be applied for non-listed companies' financial statements and stand-alone financial statements for listed companies.

In June 2011, the FSA decided that the mandatory transition to IFRS will be extended from the current minimum of three years, to five to seven years because of resistance in the business community which is labouring to recover from the Great East Japan Earthquake in March 2011.

Audit

The Japanese Corporate law requires large companies' annual accounts include a report from suitable, qualified registered auditors to the shareholders. The qualified auditors are certified public accountants (CPA) or auditing firms registered in Japan. The corporate law stipulates that large company is a company whose capital stock exceeds ¥500 million or whose total amount of liabilities as of the latest balance sheet date exceeds ¥20 billion. The Financial Instruments and Exchange Law also require listed companies to have their financial statements audited by a qualified auditor.

Accounting and reporting requirements to branches

A foreign company, which has a Japanese branch, must attach the financial statements of the Japanese branch as well as those of the company as a whole to the Japanese corporate tax return to be filed each fiscal year.

A foreign company conducting regulated business (i.e., banking or insurance) must prepare financial statements for the government in compliance with the relevant laws governing such regulated business. There are no accounting and reporting requirements applicable to a branch that conducts non-regulated businesses.

8. Information for new investors

According to Sections 4 and 6, the following comparison information regarding representative office, branch and corporation are provided particularly for new foreign investors.

General points

Potential investors must verify quite a bit before determining the entry type. The following are general factors to be checked for a representative office, branch and subsidiary:

Type	Factors to be checked
Representative Office	<ul style="list-style-type: none">a) Impossible to business operation;b) Gather information and communication only;c) Purchase and hold materials only;d) Difficult to get business trust from customer.
Branch	<ul style="list-style-type: none">a) Expand business slowly by trade or trade in Japan;b) Possible to set off a starting up loss with the HO income;c) Impossible to deduct loan interest from the parent;d) Convenient for a famous fashion brand company;e) Useful for conversion into a domestic company.
Corporation	<ul style="list-style-type: none">a) To expand business faster by business operation in Japan;b) Not necessary to disclose the parent company's accounts;c) To avoid HO director appearing in Japanese court;d) Possible to deduct loan interest from the parent.e) Necessary to consider tax treaty and foreign tax deduct;f) Easy to disclose foreign attractive company;g) Possible to get social insurance or benefits;h) Easy to employ new staff;i) Easy to gain trust from customers;j) Easy to get a loan from the bank and government.

Comparison of corporation and branch

Most foreign investors choose corporation or branch as their business in Japan. It is, however, possible to commence a branch or transfer

corporation after a couple of years. The following is a comparison of a corporation and a branch:

Point	Corporation	Branch
Capital	No limit	N/A
Dividends or Profit	Remittance subject to withholding tax at 20% (or reduced rates under tax treaty)	N/A
Loan;		
1) Loan from HO	N/A	Interest is not deductible
2) Loan from parent	Interest is deductible (thin capitalization rules)	Interest is deductible (thin capitalization rules)
3) Loan from bank	Possible	Difficult
Annual administration	Annual shareholders' meeting	No annual procedure Update registered items
Tax return submitted by the subsidiary	Submit by the subsidiary	Submit by the branch with the parent's accounts
Director	At least one representative director who is a resident of Japan	Not necessary
Hiring new staff	Attractive	Not attractive

Taxation

Scope of taxable income

Scope of taxable income of a corporation

While domestic and foreign source income is subject to a corporate tax, a foreign tax credit is allowed to a corporation.

Scope of taxable income of a branch

Only domestic source income is subject to corporate tax. No foreign tax credit is allowed for a foreign company.

A foreign company having a permanent establishment (PE) is subject to tax on all domestic source income or domestic source income attributable to the permanent establishment based on a tax treaty and must file a tax return. The remittance of funds from a Japanese branch to its foreign head office and transactions between them is generally not subject to corporate taxation.

It should be noted that by definition of PE of a foreign company, the treatment of business income, the location of source of income and taxation should be considered according to each tax treaty that may be in effect.

Representative office

A representative office of a foreign company engaged in advertising, information provision, market survey, basic research and other supplementary activities in Japan for its head office is not subject to corporate tax.

Notification to tax office regarding setting up a subsidiary

Timing	National tax office	Local tax office
A	Notification of establishment of office paying salaries, for withholding tax purposes	Notification of Incorporation Establishment of a company
B	Notification of Incorporation of a company	
C	Application of Blue Return Filers	

Notification to tax office regarding setting up a branch

Timing	National tax office	Local tax office
(Note)	Notification of establishment of office paying salaries, for withholding tax purposes	Notification of Incorporation Establishment of a company
(Note)	Notification of a Foreign Company with attachment	
(Note)	Application of Blue Form Return	

Note: No particular deadline is regulated.

9. UHY firms in Japan

UHY Tokyo & Co is proud of its lengthy and strong client relationships with a range of major listed companies in Japan, founded on our excellent audit capabilities and management relationships. With our close support and range of capabilities, several of our clients have grown from small venture companies to major leaders in their respective fields.

Our experienced specialists in International Financial Reporting Standards (IFRS) provide clients with useful guides to meeting the new standards. Our IT specialists have significant experience in IT networks. In addition, our skills and manpower are able to meet whatever requirements or challenges existing and potential clients may have for international business expansion.

What helps to make UHY Tokyo & Co unique among mid-level audit firms is our depth of experience and English-language capabilities, a combination rarely found among our competitors. Our reputation and professional standing have been built on service excellence and pride in our work.

UHY Tax Corporation renders the tax and related services. We can add value and support the organization and personnel in the tax complexities.

UHY FAS Co., Ltd provides professional services by merger & acquisitions, business restructuring, turnaround, due diligence, forensic etc. UHY FAS Co Co., Ltd provides practical advisory service for the various needs.

Services offered

Audit and Assurance
Statutory Audit
Contractual Audit
IFRS Standards
Internal Control and Risk Management
Information System Audit
Risk Audit
Accounting Systems
Tax Advisory Service

Global Taxation
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Investigation and Evaluations
Mergers and Acquisitions
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10. UHY offices worldwide

For contact details of UHY offices worldwide, or for details on how to contact the UHY executive office, please visit www.uhy.com.